INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and Regulations involved	2
Statement	2
Argument	6
Conclusion	9
Appendix A	11
Appendix B	14

CITATIONS

CASES:

Bogardus v. *Commissioner*, 302 U.S. 34	6
Comstock v. *Group of Investors*, 335 U.S. 221	7
Ferro v. *Commissioner*, 242 F. 2d 838	8
Garden State Developers Inc. v. *Commissioner*, 30 T.C. 135	7
Holloway v. *Commissioner*, decided December 12, 1951 (T.C., affirmed *per curiam*, 203 F. 2d 566	6-7
Holsey v. *Commissioner*, 258 F. 2d 865	7, 8
Kelley Co., John v. *Commissioner*, 326 U.S. 521	6
Lowenthal v. *Commissioner*, 169 F. 2d 694	8
Paramount-Richards Theatres v. *Commissioner*, 153 F. 2d 602	8
Tucker v. *Commissioner*, 226 F. 2d 177	8, 9
Wall v. *United States*, 164 F. 2d 462	7
Wilson v. *Commissioner*, 219 F. 2d 126	6
Woodworth v. *Commissioner*, 218 F. 2d 719	6, 7-8

STATUTES:

Internal Revenue Code of 1939:	
Sec. 22(a) (26 U.S.C. 1952 ed., Sec. 22(a))	11
Sec. 115(a) (26 U.S.C. 1952 ed., Sec. 115(a))	11
Sec. 115(b) (26 U.S.C. 1952 ed., Sec. 115(b))	11
Sec. 115(g) (26 U.S.C. 1952 ed., Sec. 115(g))	12
Sec. 115(j) (26 U.S.C. 1952 ed., Sec. 115 (j))	12

MISCELLANEOUS:

Rev. Rul. 58-614, 1958-51 Int. Rev. Bull. 49	7, 8, 14
Treasury Regulations 111, Sec. 29.115-9	12

In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 663

MONROE ZIPP, ET AL., *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 107a-129a)[1] is reported at 28 T.C. 314. The opinion of the Court of Appeals (Pet. 16-19) is reported at 259 F. 2d 119.

JURISDICTION

The judgment of the Court of Appeals was entered on May 21, 1958, and an order denying taxpayers' peti-

---

[1] Record references are to the appendix to taxpayers' brief below printed under separate cover.

tion for rehearing was entered on October 27, 1958. (Pet. 19.) The petition for a writ of certiorari was filed on January 24, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the purchase by a corporation of all the stock of its principal stockholder was made on behalf of the taxpayers (the new sole stockholders) and therefore resulted in the constructive receipt of dividends by them under Section 115 of the Internal Revenue Code of 1939.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939, 26 U.S.C. 1952 ed., Secs. 22 and 115, and of Treasury Regulations 111 are printed in Appendix A, *infra*, pp. 11-13.

STATEMENT

The findings of the Tax Court (R. 108a-120a) are summarized in the opinion of the Court of Appeals (Pet. 16-18) and are substantially as follows:

The Paramount Steel and Supply Company had a total of fifty shares of capital stock outstanding, all of which, except two qualifying shares held by his two sons, Bernard and Monroe, petitioners herein, were owned by Louis Zipp. On May 24, 1947, Louis caused three new certificates to be issued, two for 23 shares each in the names of Bernard and Monroe respectively, and one for two shares in his own name. The certificates issued in the names of the sons were endorsed in blank by them and delivered to the custody of their father's attorney, who was also attorney for Para-

mount. This transaction was occasioned by the fact that the father contemplated remarriage. Accordingly, he discussed with his attorney the possible effect of such step upon his financial interest in Paramount and the possibility of future marital difficulties which might jeopardize his interest in the company as well as interfere with the operation of its business. On the advice of his attorney, all except two shares of the Paramount stock owned by Louis Zipp were put in the names of his two sons "so that they could not be reached by Louis' wife, if marital difficulties arose, or in the event of Louis' death, or in the event Louis became involved in any financial deals". (R. 109a-110a, 112a-113a; Pet. 16-17.)

Some time thereafter, Louis and his sons, all of whom were officers of Paramount, became involved in controversies concerning the operation of the business of Paramount as a result of which it was orally agreed that the sons would purchase the business. Since the sons did not have sufficient funds with which to purchase the business, they arranged to borrow $75,000 from Luria Brothers, a firm with which Paramount did business. Under a written agreement, dated May 29, 1950, between Luria Brothers and Paramount, Luria loaned the latter $75,000 for which Paramount gave its note which provided for repayments of $1,500 per month, commencing July 1, 1950, and continuing until paid. The note was secured by mortgages on the real and personal property owned by the corporation. (R. 111a, 113a-115a; Pet. 17.)

On the same date, May 29, 1950, Louis and Paramount executed an agreement under the terms of which he agreed to sell his two remaining shares of stock

in Paramount to the corporation, to resign as director and general manager, to refrain from competing or interfering with the corporation's business, and to relinquish all rights and claims to further salaries and bonus compensation for 1950 and thereafter. In accordance with the terms of the agreement, Louis received from Paramount a total consideration of $93,782.50, comprised of $75,000 in cash; cancellation of an indebtedness to the corporation of $16,682.50; and an automobile valued at $2,100. The agreement also recited that the earned surplus of Paramount as of May 29, 1950, amounted to $93,790.90. Upon the closing of the transaction, Louis, at the insistence of the attorney for Luria Brothers, executed a memorandum in which he acknowledged that he had no interest, right, title or claim to the above referred to 46 shares of stock represented by two certificates for 23 shares each outstanding in the names of the taxpayers, his sons, but endorsed by them in blank. (R. 114a-117a; Pet. 17.)

A special meeting of Paramount's stockholders was held on May 29, 1950, and resolutions were adopted authorizing its president and secretary (the petitioners) to borrow money for the purpose of buying Louis' stock, to negotiate for the purchase of his stock, and to do all things necessary to accomplish those purposes. At a subsequent meeting on the same date, Paramount's stockholders ratified the agreements with Luria Brothers and Louis Zipp. (R. 117a.)

The Tax Court further found as a fact that Louis did not make completed bona fide gifts of 23 shares of stock to each of his sons on May 24, 1947, but that on the contrary he remained the owner thereof and

was such at the time he entered into the agreement with Paramount on May 29, 1950; that the total consideration of $93,782.50 received by Louis from Paramount was in exchange for all his 48 shares of stock in the company, of which two shares standing in his name were endorsed in blank by Louis and surrendered; and that after May 29, 1950, the taxpayers owned all 50 shares of Paramount stock, the funds of which company had been used to purchase 48 shares of that stock in equal shares for each brother. (R. 117a-119a; Pet. 17.)

The taxpayers did not report any income from the transaction of May 29, 1950. In determining deficiencies, the Commissioner increased the income of each son by $46,891.25, one-half of $93,782.50, on the theory that such amount had been withdrawn from Paramount by Louis in payment for 46 shares of the company's capital stock which were acquired by the sons from their father as a result of the transaction. The Commissioner concluded that the sum of $46,891.25 was taxable to each son as a dividend.[2] The Tax Court upheld these determinations upon the ground that the father, Louis, had not made completed bona fide gifts of 23 shares of stock to each of his sons in May, 1947; that his sons were mere nominees whose names were used to suit his convenience; and that Louis had re-

[2] These determinations were alternative to and inconsistent with a determination of a deficiency asserted against Louis Zipp arising out of the same transaction. (R. 119a.) When the taxpayers herein petitioned for review, the Commissioner filed a protective petition for review of the decision as to Louis. Venue in that case lies in the United States Court of Appeals for the Fifth Circuit and proceedings therein have been postponed pending final determination of this case.

mained the owner of the shares and was such at the time he entered into the agreement with Paramount on May 29, 1950. Accordingly, the Tax Court concluded that Paramount had paid Louis $93,782.50 for all 48 shares of his stock and that Louis had sold those shares, it being abundantly clear that the transactions of May 29, 1950, were to enable the sons to purchase all the father's interest in Paramount; that since Paramount was a family corporation it was possible for them to proceed as they had; that the sons had not made loans from Paramount, but had caused its cash to be distributed for their benefit, namely, to enable them to purchase all their father's stock; and that, finally, inasmuch as Paramount had accumulated earned surplus in the amount of $93,790.90, the payment of $93,782.50 by Paramount constituted taxable dividends constructively received in equal parts by the two sons. (R. 119a-120a, 124a, 128a; Pet. 17-19.)

The Court of Appeals affirmed the decisions of the Tax Court on the basis of the findings of fact and opinion of the Tax Court. (Pet. 19.)

ARGUMENT

Whether or not a corporate distribution constitutes payment for property purchased on behalf of a stockholder and whether or not a distribution in connection with a cancellation or redemption of stock is essentially equivalent to a taxable dividend constitute questions of fact. *John Kelley Co.* v. *Commissioner,* 326 U.S. 521; *Bogardus* v. *Commissioner,* 302 U.S. 34; *Wilson* v. *Commissioner,* 219 F. 2d 126 (C.A. 5th); *Woodworth* v. *Commissioner,* 218 F. 2d 719 (C. A. 6th); *Holloway* v. *Commissioner,* decided December 12, 1951 (1951 P-H T.C. Memorandum Decisions, par. 51,359), affirmed

per curiam, 203 F. 2d 566 (C.A. 6th). Thus, this case presents a question which is entirely factual and does not call for review by this Court. Both courts below have concurred in the findings that, as a result of the transaction of May 29, 1950, the taxpayers constructively received taxable dividends. A settled rule of this Court makes concurrent findings of two courts below final in the absence of exceptional circumstances. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214. The findings in this case are fully supported by the evidence, and the taxpayers have failed to show a need for further review.

1. Under the decided cases and the administrative rulings the crucial factor in determining if a purchase of stock constitutes a constructive dividend to the remaining stockholders is whether the stock is, in reality, purchased by the corporation or by the remaining stockholders. If the corporation makes the purchase the remaining stockholders do not receive a constructive dividend merely because their percentage interests in the corporation are increased. *Holsey* v. *Commissioner*, 258 F. 2d 865 (C.A. 3rd). If, on the other hand, the stock is in reality purchased by a remaining shareholder and paid for by the corporation, then, regardless of the form of the transaction, the payment is considered a dividend to the shareholder who made the purchase. *Wall* v. *United States*, 164 F. 2d 462 (C.A. 4th); Rev. Rul. 58-614, 1958-51 Int. Rev. Bull. 49, *infra*, pp. 14-15; cf. *Garden State Developers, Inc.* v. *Commissioner*, 30 T.C. 135. This is merely an application of the accepted tax principle that a purchase made with corporate funds for the benefit of a stockholder constitutes a constructive dividend to him. *Wall*,

worth v. *Commissioner, supra*; *Lowenthal* v. *Commissioner,* 169 F. 2d 694 (C.A. 7th); *Ferro* v. *Commissioner,* 242 F. 2d 838 (C.A. 3rd). See also *Paramount-Richards Theatres* v. *Commissioner,* 153 F. 2d 602 (C.A. 5th). Here, the Tax Court ruled that "[t]he arrangements had the same effect as though the sole stockholders had withdrawn funds from Paramount for their own use and benefit" (R. 128a) and this ruling is dispositive of petitioners' contentions.

2. There is no conflict of decision with either *Holsey* v. *Commissioner,* 258 F. 2d 865 (C.A. 3rd), or *Tucker* v. *Commissioner,* 226 F. 2d 177 (C.A. 8th), as asserted by petitioners (Pet. 8-10). In *Holsey,* under the particular facts of that case, the Third Circuit found that the stock was, in fact and in reality, purchased, not by the remaining stockholder, but by the corporation. Following that decision, the Service announced (Rev. Rul. 58-614, 1958-51 Int. Rev. Bull. 49, *infra,* p. 14) that it would follow *Holsey* in cases involving similar facts and circumstances, citing and distinguishing this case as being one, unlike *Holsey,* where the stock was in reality purchased by the remaining shareholders.

The *Tucker* case, *supra,* involved payments by a corporation of a percentage of its profits to a former stockholder as part consideration for the sale and transfer by him of all of his stock to an existing stockholder-manager who thereby became the owner of a controlling interest in the corporation, thus satisfying a requirement that as manager of a corporation holding an automobile-dealer franchise he have a controlling interest therein. Reversing the Tax Court which had held that the payments made constituted dividends to the stockholder who acquired the stock, the Eighth

Circuit held that that transaction satisfied a proper corporate purpose, namely, to preserve a valuable corporate asset (the franchise) and to enable the company to continue as a going concern, and that, in such circumstances, the payments should not be treated as income constructively received. As the court pointed out (226 F. 2d at 179), it was not considering a case where one in control of a corporation had, under pretense of corporate action, siphoned off its profits for purely personal purposes. In view, then, of the facts and circumstances under which the transaction in this case was effected, it is clear that here no corporate purpose was involved, but rather that corporate earnings were used solely to enable the taxpayers to accomplish their personal purpose of purchasing their father's interest in the business. Thus, the *Tucker* case, *supra*, does not involve any conflict with the instant decision.

CONCLUSION

We submit that the question presented is not one calling for review by this Court. Of necessity cases arising under Sec. 115(g) will present a variety of close factual questions. The general standard applied by the Service in dealing with such questions is clearly stated in its ruling, *infra*, p. 14. That standard is in accord with the statute, and its application to particular factual situations presents no problem warranting review.

For the reasons set forth above the petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solictor General.

CHARLES K. RICE,
Assistant Attorney General.

ROBERT N. ANDERSON,
GEORGE F. LYNCH,
Attorneys.

FEBRUARY 1959

APPENDIX A

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and

from the most recently accumulated earnings or profits. * * *

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * *

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

* * * * *

(26 U.S.C. 1952 ed., Sec. 115.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.115-9. *Distribution in redemption or cancellation of stock taxable as a dividend.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock,

to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. If a distribution is made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation, and the corporation is completely liquidated and dissolved within one year after the distribution, the distribution will not be considered essentially equivalent to the distribution of a taxable dividend; in all other cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

APPENDIX B

Revenue Ruling 58-614, 1958-51 Int. Rev. Bull. 49

SECTION 115(g).—DISTRIBUTIONS BY CORPORATIONS: REDEMPTION OF STOCK

REGULATIONS 118, SECTION 39.115(g)-1:

Distribution in redemption or cancellation of stock taxable as a dividend.

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Third Circuit, rendered September 3, 1958, in the case of *Joseph R. Holsey et ux* v. *Commissioner,* in cases involving similar facts and circumstances.

The decision holds that a remaining shareholder of a corporation does not receive a constructive dividend by way of enhancement in the value of his stock as a result of a purchase by the corporation of another shareholder's stock.

In the future, the Service will not treat the purchase by a corporation of one shareholder's stock as a dividend to the remaining shareholders merely because their percentage interests in the corporation are increased. On the other hand, if the stock is in reality purchased by a remaining shareholder and paid for by the corporation, then, regardless of the form of the transaction, the payment will be considered a dividend to the shareholder who made the purchase. This position is in accord with the decisions of *H. F. Wall* v. *Commissioner,* 164 Fed. (2d) 462, *Louis H. Zipp* v. *Commissioner,* affirmed by the United States Court of Appeals for the Sixth Circuit, May 21, 1958, and similar court holdings.

In these transactions, if a shareholder surrenders stock to a corporation for less than its fair market value, such surrender may be a gift or compensation

to the shareholders who remain interested in the corporation. Conversely, if a corporation pays more than fair market value for its stock, the payment may be compensation to the shareholder surrendering stock or may be a gift to him from the shareholders who remain interested in the corporation.